

# ~SAN MATEO~ CREDIT UNION

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P.O. Box 910 • Redwood City CA 94064-0910

April 6, 2009

Mary Rupp  
Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428  
SENT VIA EMAIL ([regcomments@ncua.gov](mailto:regcomments@ncua.gov))

Re: Advanced Notice of Proposed Rulemaking to 12 CFR Part 704

Dear Ms. Rupp:

In response to NCUA's advance notice of proposed rulemaking and request for comment (ANPR), San Mateo Credit Union (SMCU) respectfully submits the following comments. As background information, SMCU is a state chartered community based credit union in San Mateo County, California. As of December 31, 2008, SMCU had approximately \$579 million in assets serving 69,000 members.

Please note that our comment letter will not address every question raised in the ANPR. As a natural person credit union, we are not in a position to address each question, many of which require a level of expertise that is unavailable to a natural person credit union operating within the credit union system.

Moreover we believe that given the recent conservatorship actions, the National Credit Union Administration (NCUA or Agency) must thoroughly evaluate the underlying causes of the current financial crisis before undertaking any action to restructure the corporate system. We also urge the Agency to be transparent in its actions in order to regain the confidence of the credit union network.

## **The Role of Corporates in the Credit Union System**

### *Payment System Services*

In our opinion, separating payment systems services from other corporate services, specifically investments, would not have eliminated the risks of the current environment. From our understanding, the payment system services provide a revenue stream for some corporates. This revenue stream is of the utmost importance during times of constrained liquidity and writedowns on the value of securities. In addition, we believe corporate

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credit unions do offer valuable services with respect to payment system services; however, the Agency must ensure that a corporate is adequately capitalized to cover risks associated with offering such services.

## *Liquidity*

Although the current conditions are unprecedented, we believe the Agency should re-evaluate the liquidity management programs of the corporates. Natural person credit unions do not have the same breadth of liquidity sources available to them as do corporate credit unions. Therefore even in the midst of turbulent economic times, corporate credit unions must have the ability to serve as a source of liquidity. In order to ensure that there is sufficient liquidity available for the system, corporate credit unions must be required to have adequate cash on hand to meet liquidity needs. Corporates should also be required to have tested sources of liquidity outside of the corporate credit union network, including U.S. Central. For example, corporate credit unions could gain access to the discount window (Federal Reserve Bank) by relinquishing their banker's bank status.

## *Field of Membership Issues*

Although the number of corporate credit unions has decreased over the recent years due primarily to mergers, there has been an increase in competition among corporates due to the national field of membership. However despite this increase in competition, we believe that the national field of membership has been detrimental to the system as a whole. In our opinion, corporate credit unions should be focused on the needs of members within their respective region of the country or within their respective NCUA designated region. We believe that a regional based corporate credit union would have enough power to achieve economies of scale for its natural person credit unions members and would be better suited to address the needs, particularly liquidity needs, of natural person credit unions within its own region.

## *Expanded Investment Authority*

In our opinion, NCUA should conduct periodic requalification for expanded investment authority. At a minimum, we believe this review should coincide with a corporate's normal exam cycle. This regular review of eligibility for expanded authority will ensure that investment activity is appropriate given its capital, credit, and liquidity risks. However, we also recognize that regular review of a corporate's expanded authority would not have likely prevented the unrealized losses sustained by the corporate credit unions since corporate credit unions have been subject to the same market conditions as all other financial institutions across the country. Nevertheless, we believe the Agency should place risk based capital standards around corporates seeking expanded authority.

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## *Structure: two-tiered system*

We believe there remains an inherent value for the credit union system as a whole in maintaining a wholesale corporate credit union. However as the number of corporates are reduced, it is our opinion that the need for a wholesale corporate proportionally diminishes.

## **Corporate Capital**

### *Core & Membership Capital*

Under the current NCUA Rules & Regulations, core capital is defined as retained earnings plus paid-in capital (PIC). This core capital for corporate credit unions is considered Tier 1 capital and forms the basis for calculating a corporate's core capital ratio. However, corporate credit unions also issue membership capital shares (MCS) which are defined by the NCUA Rules & Regulations as "funds contributed by members that: are adjustable balance with a minimum withdrawal notice of 3 years or are term certificates with a minimum term of 3 years." Despite being available to cover losses that exceed retained earnings and PIC, MCS does not count as Tier 1 capital and is not used in calculating a corporate's core capital ratio.

We urge the Agency to review the current function of capital at corporate credit unions and to appropriately classify such capital as Tier 1. As a credit union having to write-off both its PIC and MCS at WesCorp, it appears that MCS has functioned as Tier 1 capital, and therefore, should be defined and treated as Tier 1 capital. We also believe a larger problem now exists in the fact that the confidence in the corporate network has been eroded by the write-down of PIC and MCS at WesCorp and U.S. Central. We believe the Agency will have to consider and evaluate the resistance to re-capitalizing these institutions.

### *Risk-Based Capital and Contributed Capital Requirements*

In our opinion, NCUA must implement risk-based capital for corporate credit unions which is consistent with the approach currently required for other federally regulated financial institutions. We believe that the implementation of a risk based approach is essential to measuring the true risks faced by corporates today. Failure to implement a risk based approach has the potential to weaken the entire credit union system.

### *Permissible Investments*

We believe corporate credit unions do play an important role with respect to investment services. First, the corporate system permits credit unions to aggregate their funds thereby producing higher rates of return. Second, we believe that corporate credit unions provide a level of expertise for investments that may not be available at some natural person credit unions. Because of the importance of their investment role for the credit

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union system, we believe the Agency must implement additional metrics to identify and measure risks to both the corporate network and the natural person credit union network.

## **Credit Risk Management**

SMCU believes credit risk management should be only one part of enterprise wide risk management. Given the number of risks facing corporate credit unions, we believe an independent risk management program must be established at each corporate to identify and manage the risks facing the organization.

## **Asset Liability Management**

We believe all corporate credit unions should be required to perform modeling and stress testing. However, we urge the Agency to review whether the limits set forth in the current Rules & Regulations are an appropriate tool to identify risk. We also believe independent reviews are essential to ensure the corporate is adhering to industry best practices and engaging in new developments and methodologies with respect to modeling and stress testing.

## **Corporate Governance**

Given the differences between natural person credit unions and corporate credit unions, we believe it is important for directors within a corporate credit union to be knowledgeable and trained on the particular intricacies of the corporate system, particularly with respect to the investment component of corporate activities. In our opinion, the Agency should mandate requisite criteria to become a corporate director and require annual training in the technical areas such as investments and risk management. However, we also realize that it is not reasonable to expect corporate directors to be as knowledgeable and sophisticated in the area of investments as the corporate staff. We believe it is critical for directors to have an understanding of both the benefits and risks involved with various types of investments.

Further, we do not believe “outside” directors should be required by the Agency on a corporate’s board, but we believe corporates should have the option to have “outside” directors. If “outside” directors are permitted by the Agency, the issue of compensation may have to be re-evaluated.

## **Conclusion**

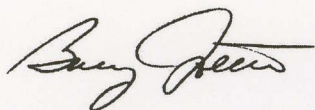
In closing, we thank you for the opportunity to express our opinions with respect to the corporate credit union system. We hope that whatever actions are taken by the NCUA will assure stability, confidence and transparency in the credit union system. Should you have any questions, you may contact me at [bjolette@smcu.org](mailto:bjolette@smcu.org) or our Compliance Officer, Karen Niederkohr, at [kniederkohr@smcu.org](mailto:kniederkohr@smcu.org).

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Sincerely,



Barry Jolette  
President and CEO  
San Mateo Credit Union

cc: Mary Dunn, CUNA